IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No. 58 of 1994

For Approval and Signature:

HONOURABLE MR.JUSTICE D.A.MEHTA
HONOURABLE MS.JUSTICE H.N.DEVANI

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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COMMISSIONER OF INCOME-TAX - Applicant(s)

Versus

JAMNAGAR JILLA SAHAKARI KHARIDVECHAN SANGH LTD. - Respondent(s)

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Appearance :
MR BB NAIK for Applicant
MR SN SOPARKAR, Senior Advocate as amicus curie for Respondent
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CORAM : HONOURABLE MR.JUSTICE D.A.MEHTA
and
HONOURABLE MS.JUSTICE H.N.DEVANI

Date : 12/12/2005

CAV JUDGMENT

(Per : HONOURABLE MS.JUSTICE H.N.DEVANI)

1. The Income Tax Appellate Tribunal, Ahmedabad

Bench “C”, has referred the following question under Section 256(2) of the Income Tax Act, 1961 (the Act) :-

> “Whether, the Appellate Tribunal is right in law and on facts in directing the Income-tax Officer to allow deduction under section 80P(2)(a)(iv) as claimed by the assessee on the gross income and not on the net income as worked out by the Income-tax Officer?”

2. The Assessment Year is 1981-82 and the relevant accounting period is the year that ended on 30.6.1980.

3. The assessee is a registered co-operative society deriving income from dividend, interest and from its trading activities. In the previous year relevant to assessment year 1981-82, the assessee had dealt in a number of commodities, including articles intended for agriculture. The assessee filed its return of income on 26.6.1981 declaring total income at Nil. Assessment was finalized on 30.6.1982 under Section 143(3) read with Section 144B on a total income of Rs.2,55,888/-. One of the adjustments made by the Assessing Officer was in respect of

the quantum of deduction under Section 80P(2)(a)(iv) of the Act. The Assessing Officer noted that the out of the aggregate sales of Rs.9,55,04,537/- in the year under consideration sales to the tune of Rs.5,01,18,140/- were of articles intended for agriculture, which included sales both to the members of the society as well as to the non-members. While computing its total income, the assessee deducted expenses to the tune of Rs.4,72,682/- from the gross profit earned out of its total sales. The assessee earned gross profit of Rs.4,00,367/- on sales of articles intended for agriculture and claimed the whole of this gross profit as deduction under Section 80P(2)(a)(iv) of the Act.

4. The Assessing Officer did not agree with this claim in principle as he was of the view that deduction can be allowed only to the extent of the net profits arising out of the activities specified in the said sub-section and not with reference to the gross profit. The Assessing Officer found that the assessee has dealt it a number of commodities and that the common expenses relating to all the activities have been

amalgamated in such a manner that the expenses relating to the activities specified under Section 80P(2)(a)(iv) of the Act cannot easily be ascertained. He, therefore, called upon the assessee to furnish details of expenditure relating to such activities. As the assessee failed to furnish such details, the Assessing Officer vide his order dated 26th June 1987, followed the decision of this Court in the case of *Sabarkantha Zilla Kharid Vechan Sangh Ltd. (1977) 107 ITR 447* and computed the expenses in relation to the activities specified in the said sub-section by applying the rule of three and bifurcated the overhead expenses of Rs.4,72,682 pro-rata. He, accordingly, held that the expenses attributable to the sale of articles intended for agriculture would be Rs.2,48,067/- and the net profit arising from purchase and sale of commodities intended for agriculture would be Rs.1,52,300/- (4,00,367/- minus 2,48,067/-). Out of the aforesaid amount, the net profits attributable to sale to non-members computed at Rs.15,230/- (10% of the net profit earned on sale of articles intended for agriculture as computed in the previous year) were deducted and the profits qualifying for deduction under Section

80P(2)(a)(iv) of the Act were computed at Rs.1,37,070/-.

5. The assessee carried the matter in appeal before the Commissioner of Income-tax (Appeals) (CIT (Appeals). Before the CIT (Appeals) it was contended that the business of the assessee society was one and indivisible and in pursuing various activities, the expenditure incurred wholly and exclusively for the purpose of the business, irrespective of the fact that the income from one or more parts of the activities was not liable to tax, was allowable in entirety and could not be apportioned and attributed towards the claim under Section 80P(2)(a)(iv) of the Act. The CIT (Appeals) vide his order dated 24th January 1985, concurred with the findings of the Assessing Officer and dismissed the appeal.

6. The assessee carried the matter in second appeal before the Income-tax Appellate Tribunal. The Tribunal found that the claim of the assessee was sought to be reduced entirely on the basis of the decision in the

case of *Sabarkantha Kharid Vechan Sangh Ltd*. (supra). The Tribunal upon considering the said decision found that in the said decision the controversy was in respect of pre-1968 provisions where the then prevailing section 81 granted an exemption to a co-operative society of profits and gains of business on specified activities, but for the purpose of granting exemption it was not as if the whole amount of profits was required to be ignored like the provisions of section 10 of the Act or the whole amount was required to be deducted like section 80P(2) of the post-1968 provisions. That, at that time relief was granted on the basis of section 110 of the Act which provided for determination of tax where total income included income on which no tax was payable. The Tribunal observed that, under the said Act, the assessee was entitled to deduction from the amount of income-tax calculated with reference to the total income, of an amount equal to income-tax calculated at the average rate of income-tax on the amount on which no income-tax was payable. That, the High Court upon considering the said section along with the other provisions of the Act had come to the

conclusion that expenditure common to both the categories of activities were required to be first set off against profits and gains of both the activities and then only chargeable income could be determined for the purpose of calculating the amount of tax and only from that amount of tax determined the average rate of income-tax was required to be taken for the purpose of relief. The Tribunal was of the view that in the light of the amendment in the Act whereby the provisions of Section 81(1) of the Act had been deleted from Chapter VII of the Act with effect from 1st April 1968, and incorporated as Section 80P in Chapter VIA of the Act, the decision in the case of *Sabarkantha Zilla Kharid Vechan Sangh Ltd.* would not be applicable to the facts of the present case. The Tribunal found that considering the change in the scheme of the Act, the decision of the Apex Court in the case of *Commissioner of Income-tax v. Maharashtra Sugar Mills Ltd., 82 ITR 452* would be squarely applicable because it was an undisputed position that the business of the assessee was one and indivisible; that, therefore, in view of the ratio laid down by the said decision there was no warrant for

any apportionment of the common overhead expenses of the two types of activities. The Tribunal observed as follows:

> *"It is clearly laid down in the said decision that when the business is indivisible and the expenses cannot be bifurcated over the two categories of the activities then the assessee would be entitled to deduction of the whole amount of the expenditure incurred. Reliance placed by the revenue on the provisions of section 80AB of the Act also does not salvage the case of the revenue because that section deals with determination of the income on the basis of the provisions of the Act. The expenditure sought to be apportioned being the common expenditure there is no question of deducting the same from the profits from the tax-free activities because such expenditure has no direct nexus with such activities nor it can be said that such expenditure cannot be related to non-taxable activities. Therefore, this ground is decided in favour of the assessee."*

Accordingly, the Tribunal vide its order dated 7.7.1989 held in favour of the assessee, insofar as the said ground was concerned.

7. This reference was taken up for hearing on 28th September 2005. Mr. B.B. Naik, learned Standing Counsel appearing on behalf of the applicant revenue had made various submissions which are set out in detail hereinafter. However, despite service of notice there is no appearance on behalf of the respondent assessee. Hence, considering the nature of the controversy involved, this Court had by an order of even date appointed Mr. S.N. Soparkar, learned Senior Advocate as *amicus curie* for assisting the Court. Accordingly, Mr. Soparkar has appeared as *amicus curie* and addressed the Court on the issues involved in the reference.

8. Heard Mr. B.B. Naik, learned Standing Counsel for the applicant revenue and Mr. S.N. Soparkar, learned Senior Advocate appearing as *amicus curie*.

9. Mr. Naik submitted that insofar as the controversy involved in the present case is concerned, the business of the assessee can be said to consist of two parts, namely (i) sale of articles intended for agriculture and (ii) sale of commodities other than

articles intended for agriculture. That, under section 80P(1), in case of a co-operative society whose gross total income includes income referable to any of the activities mentioned in sub-section (2) of section 80P the sums specified in sub-section (2) would be deductible while computing the total income of the assessee co-operative society. Accordingly in view of the provisions of section 80P(2)(a)(iv), the whole of the profits and gains of business of the assessee co-operative society attributable to the sale of articles intended for agriculture to the members of the assessee is deductible at the time of computation of its total income. It was submitted that as the income from the said activity, namely sale of articles intended for agriculture to members of the assessee was not exigible to tax, any expenditure incurred in respect of that activity is not deductible. In other words it was contended that if a part of the profits of business is not taxable, the expenditure incurred for the purpose of earning those profits cannot be allowed as a deduction. It was contended that it is a settled legal position that it is only the net income of the activities

specified in sub-section 80P(2) that is exempt.

10. Reliance was placed upon the decision of the Supreme Court in the case of *Sabarkantha Zilla Kharid Vechan Sangh Ltd. V. Commissioner of Income-tax (1993) 203 ITR 1027* whereby the decision of this Court in the case of *Commissioner of Income-tax v. Sabarkantha Zilla Kharid Vechan Sangh Ltd.*, (supra) had been affirmed, to submit that when the society is carrying on taxable as well as non-taxable activities, the deduction from tax is available only in relation to net profits of such non-taxable activities and not the gross profits thereof.

11. The learned Counsel also placed reliance upon a decision of this Court in the case of *Gandevi Taluka Khedut Sahakari Sangh Ltd. v. Commissioner of Income-tax, (1994) 207 ITR 175* to contend that while granting deduction under Section 80P(2)(a)(iv) of the Act, to co-operative societies, only the net income attributable to the activities specified under the section for the purchase of agricultural implements, livestock, etc.

intended for supplying to agriculturists which is included in the gross total income can be deducted and not the gross total income from such activities. It was submitted that applying the principles laid down in the aforesaid decision, in case the expenses from the business were indivisible the net income from exempt activities was required to be computed by deducting the expenses on proportionate basis as had rightly been done by the Assessing Officer.

12. Reliance was also placed upon the decisions of the Rajasthan High Court in the case of *Kota Co-operative Marketing Society Ltd. v. Commissioner of Income-tax, (1994) 207 ITR 608* and *Commissioner of Income-tax v. Rajasthan Rajya Sahkari Upbhokta Sangh Ltd., (1995) 215 ITR 448* to contend that the assessee was not entitled to the deduction of the entire amount of income received from the sale of articles intended for agriculture to its members without deducting the proportionate expenses thereof.

13. The learned Senior Advocate, Mr. Soparkar submitted that as per the legislative scheme only the net income is deductible. Hence,

there could not be any quarrel with the proposition that it is only the net income of the exempt activities that are deductible from the gross income while computing the total income. However, the question that would arise is that if expenses qua exempted and non-exempted income are indivisible whether the expenses are required to be allocated notionally to determine the net exempted income? Whether expenditure, qua exempt activities as well as non-exempt activities is deductible at the first stage on actual basis and at the next stage the total income is required to be computed by deducting the net income qua the exempt activities computed on a notional basis.

14. The learned Counsel submitted that in the case of *Rajasthan State Warehousing Corporation v. CIT (1994) 209 ITR 271*, the Rajasthan High Court had followed the decision of the Apex Court in the case of *Sabarkantha Kharid Vechan Sangh Ltd. v. CIT* (supra), and held that in a case where the entire business of the assessee is one and indivisible and for earning the income from different sources expenditure has to be incurred, then the expenditure which is

relatable to that income, which is taxable, is allowable under Section 37 of the Act. If the assessee had maintained separate accounts, then the expenditure could have been determined by the Income-tax Officer on the basis of such evidence which the assessee might have produced. In case where no evidence was produced by the assessee, there was no other option except to allocate the expenditure relating to taxable and non-taxable income on proportionate basis. It was pointed out that the said decision of the Rajasthan High Court, which had followed the decision of the Apex Court in the case of *Sabarkantha Kharid Vechan Sangh Ltd.* (supra) had been reversed by the Supreme Court in the case of *Rajasthan State Warehousing Corporation v. CIT (2000) 242 ITR 242*.

15. The learned Counsel contended that overhead expenses in relation to the same business cannot be allocated. It was submitted that the decisions in the case of *Sabarkantha Kharid Vechan Sangh* (supra) and *Gandevi Taluka Khedut Sahakari Sangh Ltd.* (supra) do not deal with a situation wherein the expenses are indivisible in nature. It was

further submitted that the manner of computation of income at the first stage namely question of allowability of expenditure under section 37 of the Act has been determined by the Apex Court in the case of *Rajasthan State Warehousing Corporation* (supra); that if the aforesaid decisions are not reconciled there is a conflict. Mr. Soparkar also pointed out that there are two findings of fact in the case at hand namely (i) the business is one composite indivisible business, and (ii) there are common overhead expenses. It was further submitted that in the case of *Sabarkantha Kharid Vechan Sangh Ltd*. the Supreme Court merely laid down that the computation has to be in accordance with the scheme of the Act.

16. The learned counsel further submitted that as regards mode of computation of income the lead decision was the decision of the Apex Court in the case of Commissioner of *Income-tax, Madras v. Indian Bank Limited (1965) 56 ITR 77*, which was followed by Apex Court in the case of *Commissioner of Income-tax, Bombay City I v. Maharashtra Sugar Mills Ltd., (1971) 82 ITR 452*. It was urged that

no theory of pro-ration had been applied at the first level by the Supreme Court. It was submitted that two types of situations arise while computing the income from activities that are exempted, firstly where expenses are directly allocable to the exempted activities and secondly where the expenses are not directly allocable to the said activities. It was submitted that what is not directly allocable cannot artificially by pro-ration be allocated to such activities.

17. It was submitted that the decision of this Court in the case of *Gandevi Taluka Khedut Sahakari Sangh Ltd*. (supra) deals with expenditure on direct basis and not pro-rated basis, hence, it is not an authority on the proposition that indirect expenses should also be pro-rated as contended by the learned counsel for the revenue.

18. Reliance was placed upon the decision of the Punjab and Haryana High Court in the case of *Punjab State Co-operative Supply and Marketing Federation Ltd. (1981) 128 ITR 189* wherein while considering the question of

apportionment of the expenditure, with reference to the activity which yielded income liable to tax and with reference to the activity which yielded income exempt from tax, the High Court, taking note of the finding recorded by the Tribunal that the business was one and indivisible, followed the decisions of the Apex Court in the case of Indian Bank and Maharashtra Sugar Mills Ltd. and held that the entire expenditure incurred by the assessee was deductible.

19. It was submitted that in case where the business was one and indivisible, the ratio laid down by the Supreme Court in the case of *Rajasthan State Warehousing Corporation v. C.I.T. (supra)* would be squarely applicable and accordingly, where the business activities of the assessee constitute one indivisible business, the entire expenditure will be permissible deduction.

20. Mr. B.B. Naik, the learned Standing Counsel for the applicant revenue in rejoinder submitted that while working out the total income of the assessee, all the allowable

expenditure is required to be deducted at the first stage and thereafter, the net income of the exempt activities is required to be deducted while computing the total income chargeable to tax. It was contended that if it is not possible to work out the net income qua the exempted activities, no exemption can be granted at all. It was submitted that the assessee was entitled to deduction only if the requisite conditions prescribed by the provisions are fulfilled. Hence, if the net income in relation to the specified activities could not be calculated, the assessee would not be entitled to any deduction under section 80P. In support of his contentions reliance was placed upon the decision of the Karnataka High Court in the case of *Karnataka State Co-operative Marketing Federation Ltd. V. Commissioner of Income-tax, (2001) 166 CTR 53* wherein it has been held that as per section 80AB, for the purpose of computing deductions, the amount of income of a particular nature as computed in accordance with the provisions of the Act alone is deemed to be the income of that nature; that losses incurred by the assessee co-operative society in its general section had to be deducted from the aggregate income under the

head “business income” and the net income alone would be entitled to deduction under section 80P(2)(a)(iv) of the Act; that from income from house property and income from other sources which are not eligible for deduction under section 80P, loss could not be deducted after aggregating that income with business income.

21. The principal controversy in the present case pertains to the deductibility of expenditure incurred for the business of a co-operative society in relation to the amount of profits and gains attributable to the activities specified under section 80P(2)(a)(iv) of the Act, when the business of the assessee qua specified activities and activities other than specified activities is one and indivisible and there are common overhead expenses. In other words whether the income from the specified activities is required to be deducted in toto or whether the common overhead expenses are required to be allocated on a proportionate basis, to arrive at the net income from the specified activities on a notional basis.

22. Various decisions have been cited by both the learned Counsel. The decisions of the Supreme Court and the different High Courts are as far as possible referred to in chronological order so as to properly appreciate the controversy involved in the instant case.

23. In the case of *Commissioner of Income-tax v. Indian Bank Ltd., (1965) 56 ITR 77*, the respondent, a banking company, had in the course of its business, invested a large sum in securities, including securities the interest from which was exempt from tax. Profits and losses on the purchase and sale of such securities were duly taken into account in computing the business income of the respondent. The question for decision was whether the interest paid by the respondent on the amount invested in securities, whose interest was tax-free, was deductible from its gross profits. The Apex Court held that interest paid by the respondent on moneys borrowed from its various depositors had to be allowed in its entirety under Section 10(2)(iii) of the Indian Income-tax Act, 1922 and there was no warrant for disallowing a proportionate part

of the interest referable to moneys borrowed for the purchase of securities whose interest was tax-free. The Apex Court observed thus:

> *"In section 10(2)(xv), what Parliament requires to be ascertained is whether the expenditure has been laid out or expended wholly and exclusively for the purpose of the business. The Legislature stops short at directing that it be ascertained what was the purpose of the expenditure. If the answer is that it is for the purpose of the business, Parliament is not concerned to find out whether the expenditure has produced or will produce taxable income. Secondly, the reason may well be that Parliament assumes that most types of expenditure which are laid out wholly and exclusively for the purpose of business would directly or indirectly produce taxable income, and it is not worth the administrative effort involved to go further and trace the expenditure to some taxable income.*
>
> *Therefore, it seems to us that there is nothing in the language of section 10 from which it can be fairly implied that an expenditure or allowance falling within the section must fulfill some other condition before it can be allowed."*

24. In the case of *Maharashtra Sugar Mills Ltd. (1971) 82 ITR 452*, the assessee-company was manufacturing sugar in its factory and was also growing sugarcane for purposes of its factory. On the question of deduction of expenditure, so much of the managing agency commission which was referable to the growing of sugarcane, was disallowed on the ground that the income from sugarcane cultivation was agricultural income and not exigible to tax. The Appellate Tribunal found that the cultivation of sugarcane and the manufacture of sugar by the assessee constituted one single and indivisible business. It was held by the Apex Court that the entire managing agency commission was laid out for the purpose of the business carried on by the assessee and was allowable under Section 10(2)(xv) of the Act of 1922 and that the fact that the income from growing of sugarcane, a part of that business, was not taxable under the Act, was not a relevant circumstance. The Court held as follows:

> *"The finding of the Tribunal that the cultivation of sugar-cane as well as the manufacture of sugar constitutes one business is a finding of fact. The finding has not*

been challenged before us. What was urged on behalf of the department is that the assessee's business consisted of two parts, namely (1) cultivation of sugar-cane and (2) manufacture of sugar. The former part being agricultural operation, the income therefrom is not exigible to tax and therefore any expenditure incurred in respect of that activity is not deductible. This contention proceeds on the basis that only expenditure incurred in respect of a business activity giving rise to income, profits or gains taxable under the Act can be given deduction to and not otherwise. We see no basis for this contention. To find out whether a deduction claimed is permissible under the Act or not, all that we have to do is to examine the relevant provisions of the Act. Equitable considerations are wholly out of place in construing the provisions of a taxing statute. We have to take the provisions of the statute as they stand. If the allowance claimed is permissible under the Act then the same has to be deducted from the gross profit. If it is not permissible under the Act, it has to be rejected. Section 10(2) says that profits under section 10(1) in respect of business should be computed after deducting the allowances mentioned therein. One of the allowances allowed is that mentioned in section 10(2)(xv) which says that any expenditure laid out or expended wholly and exclusively for the purpose of such business shall be deducted as an allowance. The mandate of section 10(2)(xv) is plain and unambiguous. Undoubtedly, the allowance claimed

in this case was laid or expended for the purpose of the business carried on by the assessee. The fact that the income arising from a part of that business is not exigible to tax under the Act is not a relevant circumstance."

25. In the case of *Commissioner of Income-tax v. Sabarkantha Zilla Kharid Vechan Sangh Ltd. (1977) 107 ITR 447*, this Court was of the view that in order to carry out the scheme of the Act apportionment of expenditure between taxable activities and non-taxable activities has got to be made. The Court held as follows:

"XXXXXX The scheme requires that profits and gains of non-taxable activities and taxable activities both of which are components which have entered into the total income as known to income-tax law, should be separated and that separation of these two components which have entered into the total income can only be done by finding out the proportionate net income, that is, after deducting from the amount of gross profits both for taxable activities as well as for non-taxable activities all expenditure attributable to these two categories of cases. There is no dispute before us as indeed there was no dispute before any of the authorities uptil now about the method adopted by the Income-tax Officer for arriving at the figure of proportionate net

income of taxable activities and proportionate net figure of non-taxable activities, that is, of the advisability of the rule of three in finding out the proportionate net income out of the total net income of the assessee. Since there is no such dispute, all that we are concerned in the present case is whether the law in India in the form of section 81(1)(d) and the proviso to section 81(1) read in the light of the provisions of sections 66 and 110 permits any such apportionment. In our opinion, the only way the scheme can be worked under the Income-tax Act, 1961, in connection with incomes forming part of total income on which no income-tax is payable covered by Chapter VII, is by adopting the procedure that the Income-tax Officer had done; otherwise a very curious result is likely to follow if the argument on behalf of the assessee were to be accepted. By adopting his reasoning the profits and gains of business in respect of taxable activities may be arrived at figure X by not taking into consideration the proportionate item of expenditure and, similarly, the profits and gains of business from non-taxable activities may be arrived at figure Y without taking into consideration the proportionate item of expenditure and though the total assessable income computed in the light of section 110 is nothing else but a combination of these two items, namely, profits and gains of business from taxable and profits and gains from non-taxable activities, the two figures arrived at in the light of the contention of the assessee will not add up to the

figures of the total income arrived at in light of section 110 and that would not be permissible and would also be highly illogical. Under these circumstances we have come to the conclusion that the only way of working out the scheme of the provisions of section 81(1)(d) and the proviso to Section 81(1) in the light of sections 66 and 110 is first to calculate the total income, secondly, to decide what is the income-tax payable on that total income, thirdly, to ascertain the income in respect of non-taxable activities by setting off against the gross profits of non-taxable activities, the proportionate amount of expenditure. Then, also ascertain by a similar process of setting off proportionate expenditure, the profits and gains of business from taxable activities and then ascertain the amount of income-tax assessable in the case of the assessee. If this procedure is not followed anomalous results are likely to ensue."

26. It may be pertinent to note that the Court referred to the decisions of the Apex Court in the case of *Commissioner of Income-tax v. Indian Bank Ltd., CIT v. Maharashtra Sugar Mills Ltd*. as well as decisions of the High Courts of Madras, Calcutta and Madhya Pradesh and observed as follows:

"In each of these decisions which we have so far discussed, the principal

point was in connection with section 10(2)(ii) or section 10(2)(xv) of the Act of 1922, now replaced by section 37, or similar provision of the Income Tax Act, 1961, and the ratio decidendi which flows from this line of authorities is only to the effect that if an assessee has a the business which is single and indivisible, and part of the income of that business is exempted or excluded from income-tax, it is not permissible to the income-tax authorities, to disallow any part of the total expenditure incurred in carrying on its business on the ground that part of the expenditure is proportionate to the income which is exempt or excluded from income-tax. Beyond this principle nothing else has been laid down by these decisions which we have discussed so far."

27. The aforesaid decision of this court was affirmed by the Supreme Court in the case of *Sabarkantha Zilla Kharid Vechan Sangh Ltd. v. Commissioner of Income-tax (1993) 203 ITR 1027*. The Apex Court held thus:

"Thus, when section 66 of the Income Tax Act requires the computation of total income of every person to be done by including all income on which no income-tax is payable under Chapter VII, the income on which no income-tax is payable by a co-operative society under section 81(i)(d) falling under Chapter VII, has to be necessarily included in

the total income. The above section 110 is then attracted because of the very words of its opening clause. Hence, when the assessee co-operative society's income is included in its total income, it becomes entitled to a deduction from the amount of income-tax chargeable on its total income. That means, the co-operative society concerned becomes entitled to deduction or exemption from income-tax payable by it only on its net amount of profits and gains, i.e. on income of its business otherwise computable in accordance with the provisions of the Income Tax Act for the purpose of charging income-tax thereon and which is included in its total income, and not on the amount of its gross profits and gains of business."

28. In the case of *Punjab State Co-operative Supply and Marketing Federation Ltd. v. Commissioner of Income-tax, (1981) 128 ITR 189*, the Punjab and Haryana High Court, placed reliance upon the decisions of the Supreme Court in the case of (1) *CIT v. C. Parakh and Co. (India) Ltd.*, (1956) 29 ITR 661, (2) *CIT v. Indian Bank Ltd.* (supra) and (3) *CIT v. Maharashtra Sugar Mills Ltd.* (supra) and held as follows:

"Their Lordships of the Supreme Court in the above-mentioned authorities laid down the principle that if the business of the assessee

> *is one and in pursuing various activities if the assessee incurs expenditure, wholly and exclusively for the purpose of the business, irrespective of the fact that the income from one or more parts of the activities was not liable to income tax, the entire expenditure incurred by the assessee in connection with the business, has to be allowed. In this view of the matter, the contention of Shri Awasthy, the learned counsel for the revenue, that proportionate expenditure should be allowed, is without any merit. ”*

29. In the case of *Commissioner of Income-tax v. Anakapalli Co-operative Marketing Society, (1989)175 ITR 584*, the Andhra Pradesh High Court held that what is deductible under section 80P is the gross total income attributable to activities of the nature mentioned in sub-section (2) of section 80P, gross total income as defined under section 80B(5). This decision was referred to by the Supreme Court in the case of *Sabarkantha Zilla Kharid Vechan Sangh Ltd*. (supra) and it was observed as follows:

> *“Hence, the view taken by the Andhra Pradesh High Court on the scope of 80P of the Income Tax Act which had replaced section 81 of the Income Tax Act, fully supports the view we have already expressed on the “income exemption” of profits and*

gains of a business of a co-operative society as envisaged under section 81 of the Income Tax Act read in conjunction with sections 66 and 110 thereof."

30. In the case of *Kota CO-operative Marketing Society Ltd., (1994) 207 ITR 608*, the Rajasthan High Court has held that if a co-operative society is carrying on business and earning income, part of which is exempted and part of which is not exempted, the profits and gains attributable to the exempted activity has to be arrived at on the basis of the books of account maintained by the assessee. If separate sets of books or separate accounts of expenditure have been maintained for the exempted and non-exempted activities there is no problem. If separate books of account have not been maintained and expenses have been incurred jointly for earning both the incomes then such expenses relatable to earning the non-exempted income must be estimated. The income exempted under section 80P(2) has to be arrived at separately in order to determine the income under section 80P(2) and it can never be envisaged that the total income which has been so received could be

allowed without deducting the expenditure incurred in earning the said income. The use of words “the whole of the amounts of profits and gains of business attributable to any one or more such activities” appearing at the end of sub-section (2) of section 80P could be only for such income which is attributable to the activities which are exempted. In order to ascertain the real profit, the expenses incurred in earning the said income have to be deducted. However, after stating as aforesaid, while considering the decision of the Apex Court in the case of *Maharashtra Sugar Mills Ltd*., the Court held that the same has no application as in the said case it was held that where business constitutes one single and indivisible business, the entire expenditure is to be allowed whereas the Tribunal has recorded a finding that the two businesses are not one, single and indivisible business, but are separate businesses.

31. In the case of *CIT v. Rajasthan Rajya Sahkari Upbhokta Sangh Ltd. (1995) 215 ITR 448* the Rajasthan High Court followed its decision in the case of *Kota Co-operative*

Marketing Society Ltd. (supra) and held that the expenses attributable to exempted income are required to be apportioned.

32. In the case of *Rajasthan State Warehousing Corporation v. Commissioner of Income-tax, (1994) 209 ITR 271*, the assessee a State Government Corporation, derived its income from interest, letting out of warehouses and administrative charges for procurement of foodgrains while working for the Food Corporation of India as well as the State Government. It claimed deduction of expenditure of Rs.38,13,555.17 under Section 37 of the Act in computing its income under the head “Profits and gains of business and profession”. The Income-tax Officer allowed only so much of the expenditure as could be allocable to the taxable income and disallowed the rest of it, which was referable to the non-taxable income, being exempt under Section 10(29) of the Act. The Commissioner of Income-tax accepted the assessee’s claim that the entire expenditure was deductible. The Revenue succeeded before the Tribunal and the Rajasthan High Court confirmed the order of the Tribunal, holding that expenditure relatable to taxable and

non-taxable income was allocable on proportionate basis.

33. The assessee carried the matter in appeal before the Supreme Court. The Supreme Court in its decision reported in *(2000) 242 ITR 450*, reversed the decision of the High Court and held that in view of the fact that a perusal of the question itself disclosed that income from various ventures was earned in the course of one indivisible business, the impugned order upholding the apportionment of the expenditure and allowing deduction of only that proportion of it which was referable to the taxable income, was unsustainable.

34. The controversy in question is required to be decided in the light of the legal position stated in the decisions cited above.

35. To properly appreciate the controversy in question it would be necessary to advert to the scheme of the Act. This Court in its decision rendered in the case of *C.I.T.-III v The Baroda Peoples Bank Ltd., Tax Appeal*

No.208 of 2003 and allied matters has exhaustively delineated the scheme of the Act, which is reproduced hereunder:

"Section 80P of the Act appears in Chapter VIA of the Act. The said Chapter pertains to deductions to be made in computing total income. It is divided into four heads or four parts :

A : General Sections (Sections 80A to 80B)

B : Deduction in respect of certain payments (Sections 80C to 80GGC)

C : Deductions in respect of certain incomes (Sections 80H to 80TT)

D : Other deductions (Sections 80U to 80VV)

Section 80A(1) of the Act provides that in computing total income of an assessee, there shall be allowed from the gross total income, the deductions specified in Sections 80C to 80U (in the present case 80C to 80VV)*, in accordance with and subject to the provisions of this Chapter viz. Chapter VIA. Under sub-section (2) of Section 80A a ceiling has been placed, viz, the aggregate*

amount of deductions under the Chapter shall not exceed the gross total income of an assessee. Under Section 80B(5) "gross total income" has been defined to mean the total income computed in accordance with the provisions of the Act before making any deduction under Chapter VIA. As to what is the nature of the income to be included in the gross total income is laid down vide Section 80AB of the Act. The said Section provides that where any deduction is required to be made or allowed under any section included in Chapter VIA under the heading "C-Deductions in respect of certain incomes" in respect of any income of the nature specified in any of the Sections falling under the heading 'C', then for the purposes of inclusion in the gross total income, notwithstanding anything contained in any of the said Sections, the amount of income of that nature as computed in accordance with the provisions of the Act (before making any deduction under this Chapter) shall alone be deemed to be the amount of income of the nature which is amenable to deduction and which is included in the gross total income. On a conjoint reading of Section 80B(5) and 80AB of the Act it is apparent that for seeking deduction in respect of incomes falling in

any of the sections specified under heading 'C' of Chapter VIA such income has to be computed in accordance with the provisions of the Act and then included in gross total income; gross total income means the total income, computed in accordance with the provisions of the Act, and at both the stages while computing total income deductions under Chapter VIA are not to be taken into consideration. Therefore, income under a particular head comprising of a specific item has to be in the first instance computed in accordance with the provisions of the Act, that is, all the permissible deductions/allowances have to be first taken into consideration (excluding deductions under Section VIA) and the figure of net income arrived at after such computation has to form part of the total income. In other words, the net income relatable to a particular head or item has to go in as a component of the gross total income before any deduction under Chapter VIA is to be allowed.

Once this is the scheme laid down by the statute, all such allowable expenditure, in the form of various allowances and deductions, are already taken care of from the income earned by an assessee under a

particular head. In case of income falling under the head "profits and gains of business or profession" section 29 of the Act stipulates that the income referred to in section 28 shall be computed in accordance with the provisions contained in sections 30 to 43D of the Act. Therefore, in case of an assessee carrying on business of banking in the first instance, income under Section 28 is computed in accordance with the provisions of Section 29 of the Act and such net figure is taken as a component of the total income or gross total income for the purpose of deduction under Chapter VIA. XXXXXX.

Examining the issue from a slightly different angle. One may take into consideration the provisions of Section 4 read with Section 5 and Section 2(45) of the Act. The charge of income tax is fastened under Section 4 of the Act in respect of the total income of the previous year. Such total income includes all income from whatever source derived which is either received or accrues to an assessee during any previous year. Section 2(45) of the Act defines "total income" to mean the total amount of income referred to in

Section 5, computed in the manner laid down in the Act. Thus, all income received by or accruing to an assessee during any previous year is to be charged to tax after computation in the manner prescribed by the Act. Therefore, in case of an assessee, like the present assessee, all interest income, actually received or accrued has to be computed in the manner provided in the Act so as to form the total income which is subjected to charge under section 4 of the Act. That once again gives an indication that all such income has to be computed as provided on a conjoint reading of Sections 28 and 29 of the Act and only thereafter the net figure is required to be taken up for consideration for the purpose of ascertaining deductibility or otherwise under Section 80P of the Act which falls under the heading 'C' of Chapter VIA of the Act.

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Sub-section (1) of Section 80P stipulates that in case of an assessee who is a Co-operative society, the sums specified in sub-section (2) shall be deducted while computing total income of the assessee,

provided the gross total income includes any income referred to in sub-section (2). Sub-section (2) specifies the sums which are deductible by way of specifying activities in clauses (a) to (f). In clause (a) again, the activities which are of the prescribed nature, are specified vide sub-clauses (i) to (vii). In the event of a Co-operative society carrying on any one of such businesses as specified by sub-clauses (i) to (vii) or engaged in any one or more such activities the whole of the amount of profits and gains of business attributable to any one or more activities shall be deducted. Thus, the provision itself gives an inherent indication that for the purpose of constituting the sum deductible while computing the total income of the assessee, the sum has to be the amount of profits and gains of business. It is necessary to take note of the fact that in sub-section (2) of Section 80P of the Act word 'income' is not used but the word used is 'sum' which is the 'whole of the amount of profits and gains of business'. Therefore, under sub-section (1) the gross total income has to include income from any of the specified activities and for the purpose of deduction the sums specified in sub-section (2) shall be deducted in computing the total income

of an assessee, namely, a Co-operative society. Before analyzing sub-clause (i) of clause (a) of sub-section (2) of section 80P of the Act it is necessary to take note that under sub-section (3) of Section 80P the deduction available under sub-section (1) of section 80P shall be allowed after reducing from the qualifying income, the income, if any, as referred to in sections specified therein viz. Section 80HH etc. This is one more indication available in the Scheme of the Act to denote that what is deductible under the provisions of Chapter VIA is in terms of the provisions of the Act with special reference to Section 80B(5) read with Section 80AB of the Act is the net figure."

Therefore, it is evident that as per the scheme of the Act all permissible statutory deductions are required to be made prior to making deduction under the provisions of Chapter VIA, and that what is deductible under Chapter VIA of the Act is the net figure.

36. Section 80P(1) provides that where, in the case of an assessee being a co-operative

society, the gross total income includes any income referred to in sub-section (2), there shall be deducted, in accordance with and subject to the provisions of this section, the sums specified in sub-section (2), in computing the total income of the assessee.

Sub-section (2) of section 80P insofar as the same is relevant for the present purpose reads as under:

(2) The sums referred to in sub-section (1) shall be the following, namely:-

(a) in the case of a co-operative society engaged in –

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(iv) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying them to its members, or

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the whole of the amount of profits and gains of business attributable to any one or more of such activities.

37. What section 80P (1) contemplates is that where any income referred to under of sub-section (2) forms a component of the gross total income of a co-operative society, the

society would be entitled to deduction of the sums specified in sub-section (2) in respect of the amount of profits and gains attributable to the activities specified in sub-section (2).

38. In the present case the specified activity, namely sale of articles intended for agriculture to the members of the assessee society, falls under sub-clause (iv) of section 80P(2)(a) of the Act, and accordingly, the whole of the profits and gains attributable to the said activity is deductible while computing the total income of the assessee.

39. Section 80A provides that the deductions specified in sections 80C to 80VV shall be allowed from the gross total income in computing the total income of an assessee. “Gross total income” for the purpose of Chapter VIA is defined under section 80B(5) to mean the total income computed in accordance with the provisions of the Act, before making any deduction under the said Chapter or under section 280-O. Section 80AB provides that for the purpose of computing

deduction under any of the sections included under heading “C. Deductions in respect of certain incomes” of Chapter VIA the amount of income of the nature specified in that section as computed in accordance with the provisions of the Act (before making deduction under Chapter VIA) shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in his gross total income.

40. Applying the principles laid down by this Court in the case of CIT v. Baroda Peoples Co-op. Bank Ltd (supra) to the facts of the present case, in the first instance, income under the particular head namely profits and gains of business or profession comprising of the specific item namely profits and gains from activities specified under sub-clause (iv) of clause (a) of sub-section (2) of section 80P is required to be computed in accordance with the provisions of the Act, i.e. all permissible deductions/allowances have to be first taken into consideration (excluding deductions under section VIA) and the figure of net income arrived at after such computation has to form part of total

income.

41. Therefore, in the first instance the income of the assessee under section 28 is required to be computed in accordance with the provisions of section 29 of the Act. Section 29 provides that the income referred to in section 28 shall be computed in accordance with the provisions contained in sections 30 to 43A. Section 30 to 36 provide for specific deductions and section 37 which is relevant for the present purpose provides for general deductions. Under section 37, any expenditure (not being expenditure of the nature described in sections 30 to 36 and section 80VV and not being in the nature of capital expenditure or personal expenses of the assessee), laid out and expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head “Profits and gains of business or profession”.

42. The Apex Court in the case of Indian Bank and Maharashtra Sugar lays down in the context of section 10(2) and 10(xv) of the

Act of 22 which is *pari materia* to section 37 of the Act of 1961, that what is required to be ascertained is as to whether the expenditure is laid out wholly and exclusively for the purpose of business. The said section does not envisage any further inquiry as to whether the expenditure has produced or will produce taxable income. The fact that the income arising from a part of that business is not exigible to tax under the Act is not a relevant circumstance. Applying the aforesaid principles, to the facts of the present case, while computing the gross total income in terms of section 80B(5), at the first stage all that is required to be seen is whether the expenditure is laid out wholly and exclusively for the purpose of business as envisaged under section 37 of the Act. Hence in the first instance, the expenditure incurred wholly and exclusively for the purposes of the business including the expenditure incurred in relation to the specified activities would be required to be deducted under section 37 of the Act. Therefore, common overhead expenses would be deducted in entirety at the first stage under section 37 of the Act.

43. Apart from deductions under section 37, all permissible deductions/allowances have to be taken into consideration to arrive at the “gross total income” as defined under section 80B(5). It is from this gross total income that amount of profits and gains of business attributable to the specified activity, namely sale of articles intended for agriculture to members of the assessee society is to be deducted to compute the total income of the assessee.

44. In view of the provisions of Section 80AB of the Act, the amount of income from the specified activity computed in accordance with the provisions of the Act (before making deduction under Chapter VIA) shall be the income derived by the assessee from the specified activity and which forms part of the gross total income. In relation to the applicability of Section 80AB of the Act, the Tribunal has held that the same does not salvage the case of the revenue because the said section deals with determination of income on the basis of the provisions of the Act. That the expenditure sought to be apportioned being common expenditure, there

is no question of deducting the same from the profits of the tax free activities because such expenditure has no direct nexus with such activities nor can it be said that such expenditure cannot be related to non-taxable activities.

45. The moot question, therefore, would be as to what is the amount of profits and gains attributable to the activities specified under section 80P(2)(a)(iv) of the Act, insofar as the assessee is concerned, in view of the fact that the business of the assessee is one and indivisible and there being common overhead expenses, it is not possible to bifurcate the expenses qua exempted and non-exempted activities.

46. As can be seen from the order of the Tribunal, it has recorded a finding of fact after appreciating the evidence on record that the business of the assessee is one and indivisible; that the expenditure sought to be apportioned in common expenditure; the said expenditure has no direct nexus with the specified activities and it cannot be said that such expenditure is not relatable

to the taxable activities. In the circumstances, it is not possible to carve out (compute) the expenditure attributable to the specified activities out of the common overhead expenses, to arrive at the net income from such activities. If the method adopted by the Assessing Officer is followed and the expenditure is apportioned on pro-rata basis, the same would be on a notional basis and it cannot be said that the said expenditure is relatable solely to the specified activity. Hence, the net income of the specified activity so arrived at would be a notional figure and not an actual figure.

47. Considering the decisions cited above, the main decision relied upon on behalf of the revenue is the decision of the Apex Court in the case of *Sabarkantha Kharid Vechan Sangh Ltd*. (supra), whereas the main decision relied upon on behalf of the assessee is the decision of the Apex Court in the case of *Rajasthan State Warehousing Corporation* (supra). In the case of *Sabarkantha Kharid Vechan Sangh Ltd.* (supra), there was no dispute about the method adopted by the Income-tax Officer for arriving at the

figure of proportionate net income of taxable activities and proportionate net figure of non-taxable activities, namely, of the advisability of the rule of three in finding out the proportionate net income out of the total net income of the assessee. Hence, as there was no such dispute, all that the Court was concerned with was whether the provisions of section 81(1)(d) and the proviso to section 81(1) read in the light of the provisions of sections 66 and 110 of the Act, permitted any such apportionment. Which is not so in the present case; in that the advisability of the rule of three in finding the proportionate net income is not only disputed but forms part of the main controversy. There is no quarrel with the proposition as regards apportionment of expenditure to arrive at the net income in respect to taxable activities and exempt activities. The crux of the matter lies in the fact that the activities being one and indivisible it is not possible to apportion the expenditure on an actual basis. The question therefore, is whether apportionment is permissible on a notional basis.

48. In the case of *Sabarkantha Kharid Vechan Sangh Ltd.* (supra) the Apex Court has held that when the assessee co-operative society's income is included in its total income, it becomes entitled to a deduction from the amount of income-tax chargeable on its total income. That means, the co-operative society concerned becomes entitled to deduction or exemption from income-tax payable but it is only on its net amount of profits and gains, i.e. on income of its business otherwise computable in accordance with the provisions of the Income Tax Act for the purpose of charging income-tax thereon and which is included in its total income, and not on the amount of its gross profits and gains of business. Under the scheme of the Act as it stood at the relevant time what was exempted was the income-tax payable by the assessee in relation to the exempted activities, which was computable in the light of the sections 66 and 110 of the Act. Section 81 fell under Chapter VII of the Act under the heading "Incomes Forming Part of Total Income on which no income is payable". Under section 110 read with section 66 the Act (as it stood at the relevant time), there was a

special machinery for determination of tax where total income of an assessee included income on which no tax is payable. However, the provisions of section 81(1) have been deleted from Chapter VII of the Income-tax Act, 1961 with effect from April 1, 1968 and incorporated as section 80P in Chapter VIA of the Act. Therefore, there is a change in the very scheme of the Act, in relation to income of co-operative societies. However, the Apex Court has taken support from interpretation as to the scope of section 80P of the Act to express its view on interpretation of section 81 of the Act (as it then stood) as stated at page 1035 of the reports.

49. In the case of *Rajasthan State Warehousing Corporation v. Commissioner of Income-tax* (supra) the question before the Apex Court was as to whether in the facts and circumstances of the case and the business of the assessee being one and indivisible, the Tribunal was right in law in holding that the expenses have to be allocated in the same percentage as the different sources of income and not to be allowed in entirety. In the facts of the said case the Income-tax

Officer had allowed only so much of the expenditure as could be allocated to the taxable income and disallowed the rest of it which was referable to the non-taxable income, being exempt under section 10(29) of the Act. The Apex Court after considering its decisions in the case of *CIT v. Indian Bank Ltd.(supra) CIT v. Maharashtra Sugar Mills Ltd. (supra), Waterfall Estates Ltd. v. CIT (1996) 219 ITR 563* as well as the decision of the Punjab and Haryana High Court in the case of *Punjab State Co-operative Supply Marketing Federation Ltd. v. CIT (1981) 128 ITR 189 (P&H)* laid down the following principles:

(i) if income of an assessee is derived from various heads of income he is entitled to claim deduction permissible under the respective head whether or not computation under each head results in taxable income;

(ii) if income of an assessee arises under any of the heads of income but from different items, e.g., different house properties or different securities, etc., and income from one or more items alone is taxable whereas income from the other item is exempt under the Act, the entire permissible expenditure

in earning the income from the head is deductible; and

(iii) in computing "profits and gains of business or profession" when an assessee is carrying on business in various ventures and some among them yield taxable income and others do not, the question of allowability of the expenditure under section 37 will depend on :

(a)fulfillment of requirements of that provision noted above; and (b) on the fact whether all the ventures carried on by him constituted one indivisible business or not; if they do, the entire expenditure will be a permissible deduction but if they do not, the principle of apportionment of the expenditure will apply because there will be no nexus between the expenditure attributable to the venture not forming an integral part of the business and the expenditure sought to be deducted as the business expenditure of the assessee.

In the said case, on behalf of the revenue it had been conceded that if the exempted income and the taxable income are earned from one indivisible business, then the apportionment of the expenditure cannot be sustained. In the facts of the said case it was held that the income from various ventures having been earned in the course of

one indivisible business, the impugned order upholding the apportionment of the expenditure and allowing deduction of only that proportion of it which is referable to taxable income is unsustainable.

50. In the light of the aforesaid decisions, it is clear that there are two lines of judgements taking two different views. In the case of *Sabarkantha Zilla Kharid Vechan Sangh Ltd*. (supra) it has been laid down that the expenditure qua taxable and non-taxable activities has to be apportioned on a proportionate basis, though under a different scheme of the Act, whereas in the case of *Rajasthan State Warehousing Corporation* (supra) it has been laid down that where the expenditure is one and indivisible, the entire expenditure will be a permissible deduction.

51. Section 80P has been introduced in Chapter VIA of the Act with a view to encourage and promote the growth of the co-operative sector in the economic life of the country and in pursuance of the declared policy of the Government. While interpreting section

80P of the Act the object of the provision must be borne in mind and a liberal construction should be made so as to achieve the object of the provision. It is settled legal position that when two views are possible, the one which favours the assessee must be adopted.

52. In the circumstances, the view taken by the Apex Court in the case of *Rajasthan State Warehousing Corporation* (supra) that in case where the ventures carried on by the assessee constitute one indivisible business the entire expenditure will be permissible deduction requires to be applied as the same is in consonance with the scheme of the Act as stated hereinbefore. Even otherwise, the said expression of law, being the view that favours the assessee is required to be adopted. Even the decision in *Sabarkantha Zilla Kharid Vechan Sangh Ltd.* (supra) cannot strictly speaking be said to be taking a contrary view, considering the fact that in the said case there was no dispute as regards the applicability of the rule of three in finding out the proportionate net income out of the total net income of the assessee, whereas that is the central

dispute in the present case.

53. The view taken by the Tribunal that common expenditure cannot be apportioned for deducting the same from the tax free activities because such expenditure has no direct nexus with the tax free activities nor could it be said that the said expenditure was not relatable to the taxable activities is in consonance with the principles laid down by the Apex Court in the case of Rajasthan State Warehousing Corporation (supra). In the circumstances, the Tribunal was justified in directing the Income-tax Officer to allow deduction under section 80P(2)(a)(iv) as claimed by the assessee on the gross income and not on the net income worked out by the Income-tax Officer.

54. The question referred is accordingly answered in the affirmative, that is, in favour of the assessee and against the revenue. The reference is disposed of accordingly, with no order as to costs.

55. Before parting, the Court records its

appreciation for the assistance rendered by Shri Soparkar as amicus curie.

[D.A.MEHTA, J.]

[HARSHA DEVANI, J.]

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